



PEABODY ENERGY

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June 10, 2005

Mr. Tom Kennedy
Illinois Commerce Commission
527 East Capitol Avenue
Springfield, IL 62701

Re: **Peabody Energy Comment on Draft Study Entitled**
Evaluating the Potential Impacts of Transmission Constraints on the
Operation of a Competitive Electricity Market in Illinois

Dear Tom,

Peabody Energy thanks the Illinois Commerce Commission (ICC) for the opportunity to participate on the Illinois transmission study which was commissioned by the ICC. We commend the State as well as the ICC in its pursuit of free and fair markets for electricity in the state that yield competitively priced energy and sustainable economic progress. Find contained within this letter our comments on the draft study report entitled, "Evaluating the Potential Impacts of Transmission Constraints on the Operation of a Competitive Electricity Market in Illinois" dated April 2005.

The University of Illinois and Argonne National Laboratory are to be commended for taking a very complex issue and boiling it down in such a way as to draw from the effort some meaningful conclusions. However, those conclusions are only as good as the assumptions that under gird the analysis being performed.

Assumed Natural Gas Fuel Cost

Peabody Energy has a major concern with the fuel price assumptions in the study. We believe the assumed fuel price for natural gas has led the conclusions of the study to give a false sense of security with the transmission system in Illinois. The fuel price assumptions used in this study are grossly inaccurate for natural gas and we believe that the entire results of the study could be dramatically skewed as a result. By using an artificially low natural gas price you mute the effects of transmission congestion and the predicted number of hours in which the system experiences congestion is understated. From the footnote found on page 42, it appears as though the study used an EIA report from 2003. Much has changed in those two short years. There is a major disconnect from the \$2.89/mmBTU used in the study and the currently active traded market place which exceeds \$7.00/mmBTU in 2007.

In addition, EIA and other forecasting agencies, that make forward projections about fuel prices, have undergone a reality check since 2003. I know that a quick review of the data will bear out that such agencies have dramatically increased their forecast for future periods during this same period of time. A couple of years ago, energy industry professionals believed that the high gas prices were an anomaly and that gas prices, over time, would ultimately trend back towards historic levels with some minor escalation. The popular view today is that the inherently tight supply-demand market for natural gas has driven markets to a new higher plateau.

In 2003, MISO performed a similar analysis (to that commissioned by the ICC) as a part of their Regional Transmission Expansion Planning effort (MTEP03). In their study they used \$3.50/mmBTU as their baseline price for natural gas and ran sensitivity analysis at \$5.00/mmBTU to see how the transmission system performed under a “high gas” scenario. In this study they found that potential transmission upgrades had much greater value and could be more easily justified based on the “high gas” scenario. This is based on the underlying fact that transmission is a fuel arbitrager. Transmission moves low cost generation (presumably as a result of low input fuel costs) to pockets or regions where high cost generation is on the margin (presumably because of high input fuel costs). This type of high gas price scenario has led to similar results in many other transmission studies including the CERA Eastern Interconnection Transmission Bottleneck Study in 2004 and the Western Governor Association Transmission Study in 2001.

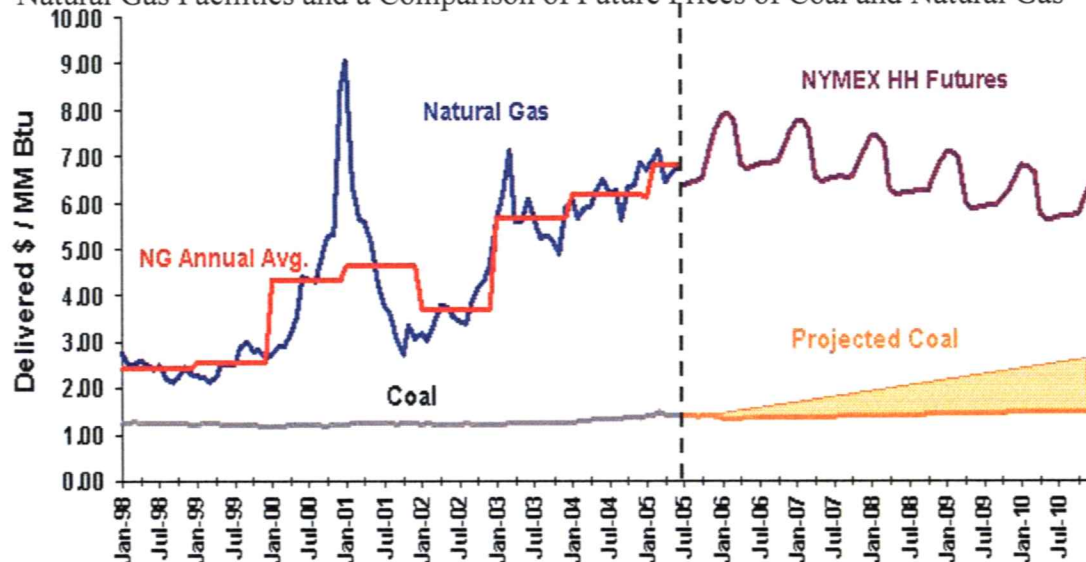
Even if this study determined to use \$2.89/mmBTU for its baseline fuel price for natural gas it would be short sighted to not perform sensitivity analysis at much higher prices. It seems prudent to at least consider high gas prices for Illinois markets in light of the recent sustained high gas prices and unprecedented volatility that we have experienced in the natural gas market place over the last few years. By restricting your view of natural gas fuel costs to a very low figure, the study mutes the possible congestion costs because the incremental costs to generate from all resources is reasonably low. Reference Table 1 below.

TABLE 1: Generation Incremental Cost Comparison Considering Assumed Input Fuel Price from Study

Generation Resource	Input Fuel Price	Generic Heat Rate	Incremental Cost
Base Load Coal	1.18/mmBTU	10,500 BTU/kwh	\$12.39/mwh
Combined Cycle Gas	2.89/mmBTU	7,000 BTU/kwh	\$20.23/mwh
Simple Cycle Gas	2.89/mmBTU	10,000 BTU/kwh	\$28.90/mwh

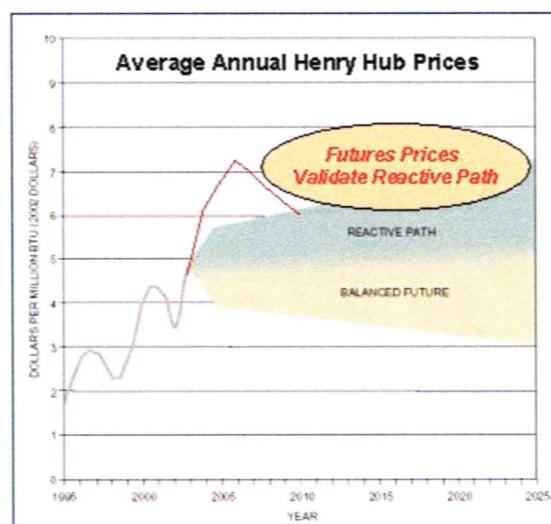
I have also included two exhibits to demonstrate the glaring differences between the realities of the current market place and the assumptions of the study. No fresh projections reflect any where near a \$3.00/mmBTU price level for natural gas.

Exhibit 1: EIA Historic Delivered Fuel Prices for Coal Facilities Compared to Natural Gas Facilities and a Comparison of Future Prices of Coal and Natural Gas



Delivered cost of fossil fuel at steam electric utility plants.
Source: Energy Information Administration, Electric Power Monthly and May 2004 Short-Term Energy Outlook. NYMEX HH Futures closing price for June 2005.

Exhibit 2: National Petroleum Council Projected Natural Gas Prices based upon a Balanced and Reactive Future Scenarios.



Note: Natural gas prices shown are average annual prices at Henry Hub, the reference/delivery point for NYMEX futures contracts. (June 2005)

Source: National Petroleum Council report to Secretary Abraham, September 25, 2003.

General Comments

Peabody Energy would also like to make some general comments on the study and its conclusions.

The study appeared to look primarily at congestion with generating sources bidding in at their production costs. Can one interpolate from these results that the expected congestion will be about the same for all bidding strategies? For instance if all generators bid in at a level closer to the "market price," would congestion increase, decrease or stay the same. Do congestion costs stay about the same despite increases in magnitudes of bids, vary linearly with bid price or vary non-linearly with bid price?

Figures 4.3.2-1, 4.3.2-3, 4.3.2-7 and 4.3.2-9 appear to be a cause for concern. It appears that these graphs would reflect demand inelasticity. In several of these scenarios, the demand (amount of generation selected in the market) is unresponsive to increases in cost of generation (bid price). In some cases when generators increase their bids 10 or 20 fold, the same amount of generation is selected in the market place, independent of price. This suggests that generators could charge whatever they want and loads will be forced to pay.

Charts and graphs that reference multiples of incremental costs are somewhat misleading. If a base load generator has an incremental cost of \$12/mwh then a 10 fold and 20 fold increase would be \$120 and \$240 respectively. In the current market pricing levels in this range are not out of the question. From references in the report and comments made at the May 10th meeting, some were of the opinion that these were unrealistic price points. We disagree.

We thank you in advance and are grateful for your consideration of these comments.

Sincerely,



J. Scott Yaeger

cc: Scott Wiseman
Harry Stoller
Jacob Williams